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Joint Policy Committee / Regional Planning Program

ITEM #6

Date: April 4, 2005

To: Joint Policy Committee

From: Regional Planning Program Director

Subject: Fiscal Reform and Smart Growth

At its meeting of March 25, 2005, the Joint Policy Committee (JPC) requested a report back at its next meeting on possibilities for pursuing smart-growth-related fiscal reform through the current seating of the State Legislature. This is that report.

Proposition 13 and its Aftermath

In the limited time available to prepare this report, I have conducted a first-cut survey of the many analyses done of post-proposition-thirteen local-government finance in California. Most of those analyses are highly partisan and tend toward the polemic. Unfortunately local-government finance in California has become so complex and involves so many uncontrolled and uncontrollable variables that it effectively defies scientific study. Many presumed benefits and costs are theoretical and unconfirmed by hard empirical evidence. With that caveat, I have appended to this report two relatively objective and comprehensive assessments of the situation. The first is an article in the Sacramento Bee done on the twenty-fifth anniversary of Proposition 13. This provides a good "Cliffs Notes" version of the story. A more complete, albeit somewhat less charitable, telling is in the dated but still relevant paper from Jeffrey Chapman for the Public Policy Institute of California.

One fundamentally important observation is that the current situation is not just the result of Proposition 13 but is the sum of the original Jarvis-Gann amendment and all the adjustments and allocations that have been made since to compensate and then compensate again for the compensations. My own admittedly superficial summary of the result and of the consensus of the more objective analysts is this:

Positives

- Some low-income and elderly homeowners have been protected from increases in property taxation (as have some less deserving individuals and corporations depending on how long they have held their properties);

- Some property owners have a more certain, more predictable, more stable tax environment;

- There has been some moderating influence on the cost and growth of government and some incentives for greater efficiency and civic entrepreneurship; but.

Negatives

- There has been increased separation and confusion between the accountability and the authority for local revenue and expenditure decisions;
- There has been a proliferation of anomalies and inequities—both between residential and commercial property classes and within classes;
- Local government revenue has become less certain and more volatile;
- The potential effectiveness of local government has been eroded and there has been some loss of service and degradation of service quality;
- The distribution of fiscal incentives and controls may be sending the wrong signals to land-use decisions, contributing to the over-supply of retail and the under-supply of housing;
- In spite of all the problems, (and in spite of the fact that the equity concerns that nominally spawned Prop 13 could have been solved with more effective and less disruptive means: e.g., a combination of income-tax credits for low-income home owners and deferred taxation for the elderly) fundamental reform is highly unlikely (Proposition 13 is a sacred cow straddling a third rail.).

<u>Potential Reforms</u>

While as local-government officials the JPC's members have an interest in all the consequences of Proposition 13 and its progeny, the JPC as a body is primarily interested in the penultimate bullet point under negatives: the signals which the composite revenue system sends to the land-use control system.

Of the system tweaks proposed to deal with that problem, arguably the most effective would have been AB 1221 (Steinberg and Campbell) which failed to pass during the 2003-2004 sitting of the Legislature. This would have permitted local governments to swap a portion of their sales tax revenues for state property tax revenues, thus leveling the scales between residential and retail uses. There is no comparable bill before the current session.

However, SB 1060 (Campbell) and AB 1146 (Huff) would signal an intent to authorize a more limited version of tax-base sharing and give effect to the one of the provisions of the constitutional amendment put into place by passage last year of Proposition 1a. This would permit multiple jurisdictions within a single county to negotiate the exchange of sales and property tax revenues among those local jurisdictions. My preliminary assessment of this newly available constitutional provision is that it would be of limited interest to cities and counties in the Bay Area and of limited effectiveness in facilitating smarter growth. However, it may be helpful to test this assumption with a couple of hypothetical Bay Area case studies, if only to demonstrate that more far-reaching tax-base sharing may be required, as in Steinberg and Campbell. If the JPC is interested in pursuing an exploration of Proposition 1a tax-base sharing and a comparison to the previous AB 1221 scheme, ABAG would be the appropriate agency to commission and manage this study.

Another bill which did not achieve passage during the 2003-2004 sitting was SB 17 (Escutia). This bill has been carried over and strengthened in a new SB 17 (Escutia) which is before the current session. SB 17 would move toward a split roll by modifying the definition of change of ownership for corporately owned commercial properties and tightening ownership reporting requirements. This would result in commercial properties being assessed more frequently than at present. More frequent reassessment would, in turn, reduce current inequities, enlarge the overall base and redress the imbalance between the commercial and residential bases. Opponents argue that it would stifle investment, economic development and job creation.

The proponents of the split roll employ the ideas of Henry George and others to argue that more frequent assessment of commercial properties would have positive land-use effects, encouraging in-fill and redevelopment. They do not explicitly observe that the land-use benefits of current market valuation apply equally well to the commercial and residential bases. While a split roll may arguably have some positive land-use effects, the principal reasons for its pursuit relate to equity and revenue generation. While these potential benefits are worthy from a local-government finance perspective and merit nominal support, I fear that their active pursuit could be a diversion for the JPC relative to its transportation and land-use mandate, particularly given the well-financed opposition.

ACA 7 (Nation) proposes to reduce the voter requirement for special taxes from the current super-majority of 2/3 to 55 percent. To the extent that this permits local governments to finance infrastructure and other services from general revenue and reduce the reliance on impact fees and other exactions, it may have positive land-use impacts. Its primary purpose is, however, to permit our communities to become more livable by reducing the ability of a minority to hold incremental revenue hostage. While not central to the JPC's mission, the Bill merits support.

Directly germane to the JPC's smart-growth mandate is AB 1259 (Daucher). This bill is also likely to be the most contentious among JPC members and among Bay Area local governments. This bill would declare the Legislature's intent to enact legislation that would reward cities and counties that exceed 80% of their Regional Housing Need Assessment (RHNA) goals over a five-year period with an increased share of the annual tax increment that is allocated among local agencies in a county. God or the Devil is clearly in the details of legislation like this, but there are no details yet.

A parallel initiative from the Business, Transportation and Housing Agency, not yet codified in draft legislation, proposes to take Councils of Government (ABAG in the Bay Area) out of most of the RHNA process, making local governments directly responsible to the State, which would also impose sanctions for non-compliance. A well-structured regional RHNA process, coupled with appropriate incentives could be a major tool for achieving regional smart-growth objectives, but there is some possibility we could lose this tool and the opportunity it provides. This clearly calls for an aggressive counter proposal from ABAG.

Finally there is AB 1033 (Daucher). This bill would appear to redress some of the presumed evils of the Education Revenue Augmentation Fund (ERAF), which diverted former county property tax revenue through the State for educational purposes. The bill seems to return some of these revenues to counties. To the extent that property tax revenues provide incentives for appropriate development, this is a good thing, and the bill may be moving in the right direction. However, the bill is also a prime example of how arcane the system of local government finance has become. A reading of the bill provides no indication of its real impact if any.

Conclusion

There are a few opportunities in the current legislation session to influence the structure of local government finance so as to make it more friendly to the objective of smart growth. The JPC itself has no legislative affairs capability, but can recommend directions to the legislative functions of its constituent agencies. The JPC may also request those agencies to undertake work related to the JPC's mandate.

Recommendation

I RECOMMEND:

A. THAT the JPC express support for the objectives of SB17 (split roll), ACA 7 (reduced super majority), and AB 1033 (property tax allocation);

B. THAT the JPC request ABAG to consider and report back on the advisability and feasibility of conducting cases studies comparing the smart-growth benefits of alternative tax-sharing schemes—including, but not limited to, those permitted by Proposition 1a and the Steinberg and Campbell proposal of 2003-2004;

C. THAT the JPC urge ABAG to formulate a proposal for an RHNA process which pursues the smart-growth vision and provides appropriate incentives to local governments.